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# In the Supreme Court of the United States

OCTOBER TERM, 1938

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

THE F. & R. LAZARUS & COMPANY

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above cause on February 16, 1939, affirming the decision of the United States Board of Tax Appeals.

### OPINIONS BELOW

The opinion of the United States Board of Tax Appeals[1] (R. 24–33) is reported in 32 B. T. A. 633.

[1] The opinion of the Board covers two cases, Docket Nos. 69481 and 69750, which were consolidated for hearing and report. (R. 24.) Both the Government (in No. 7686) and

The opinion of the Circuit Court of Appeals (R. 173–179) is reported in 101 F. (2d) 728.

## JURISDICTION

The decree of the Circuit Court of Appeals was entered February 16, 1939. (R. 173.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Taxpayer conveyed certain real property, and made an assignment of long term leases on other property, receiving in return, in addition to a cash consideration, a 99-year lease upon the premises conveyed, with options of renewal and purchase. Should this transaction be treated as a mortgage to secure a loan or a sale in determining whether the taxpayer is entitled to deduct depreciation for the taxable years involved on the buildings occupied by it under the 99-year lease.

## STATUTE INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *

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the taxpayer (in No. 7687) filed petitions for review and the cases, by stipulation of the parties, were consolidated for briefing and argument before the court below, which in turn covered both cases in one opinion. (R. 173.) Only the judgment in No. 7686 is covered by this petition.

(k) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

STATEMENT

The facts, pertinent herein, as found by the Board of Tax Appeals (R. 25, 26–28), are as follows:

Taxpayer, an Ohio corporation organized in 1851, operates a department store in Columbus, Ohio. In 1928 it was conducting its business in three buildings which it had previously constructed at an aggregate cost of $2,467,952.57. Two of the buildings were erected on ground then owned by the taxpayer in fee, and the third building, erected in 1921 at a cost of $258,054.71, was constructed on ground held by the taxpayer under a 99-year lease with option to purchase, acquired in 1915. It also held another

parcel of ground under a 99-year lease with option to purchase. (R. 25.)

In 1928, the taxpayer had a mortgage of $1,700,000 outstanding on the property it owned in fee and owed slightly more than $1,500,000 for money borrowed on short-term notes, and sought means of spreading the obligations over a longer period of time. The only avenue open to it was the equities it had in its real property. A banking house in Chicago, the holder of taxpayer's short-term notes, suggested a loan of $3,750,000 for 25 years at 5 per centum interest secured by a mortgage on taxpayer's real property, conditional upon the purchase of the notes at 97.25 and the creation of a sinking fund, which, with interest on the loan and trustee expenses, would have involved an outlay of $210,000 per year. The Huntington National Bank of Columbus, one of taxpayer's bankers for about 15 years, suggested a loan of $3,500,000 at 5 per centum based upon the issuance of land trust certificates on taxpayer's real property at a price of 96.75, and the creation of a sinking fund for repayment of the loan. The proposal of the Huntington National Bank of Columbus, limited to $3,250,000 in amount, was accepted by the taxpayer because the loan to be made under it was self-liquidating. (R. 26.)

The transaction was closed in this manner: The taxpayer executed and delivered to the Huntington National Bank of Columbus, trustee, a deed to

the parcels of property it held in fee and assignments of the 99-year leases it held for the remaining property, and concurrently therewith the trustee leased the property to the taxpayer for a term of 99 years, with an option of renewal for like terms and to purchase at specified prices, and executed a declaration of trust between itself and holders of the land trust certificates relating to the issuance of 3,500 certificates, each of the face amount of $1,000. Of the 3,500 certificates, 250 were held in reserve pending the exercise of the option to purchase the parcels covered by the 99-year leases assigned to the trustee by the taxpayer. The sum of $3,159,687.50 ($3,250,000 less discount of 3.25 per centum) was received by the taxpayer from the Huntington National Bank of Columbus under the transaction. This sum was used by the taxpayer to take up its mortgage on the property and short-term notes. The release of the mortgage, the deed to the trustee, and the declaration of trust were recorded consecutively on June 28, 1928. (R. 27.)

The lease from the trustee to the taxpayer provides, among other things, for annual rentals during the term of the lease based upon an annual return of 5 per centum on $3,250,000, that the lessee shall create a depreciation fund and make quarterly payments to the trustee for deposit therein until the fund reaches the sum of $2,600,000, and that such obligation may be satisfied by the deliv-

ery of cash, land trust certificates issued under the declaration of trust, or obligations of the United States; that the lessor shall pay interest on the amounts deposited in such fund, provided that any amounts may be, at the request of the taxpayer, invested in obligations of the United States or certificates issued by the trustee under its declaration of trust; that the lessee shall have the option to purchase the lessor's interest in the property for $3,605,000 between June 1, 1933, and May 31, 1938; for $3,570,000 between June 1, 1938, and May 1, 1948; for $3,535,000 after June 1, 1948, plus, in each case, accrued rentals to the date of purchase; that in case the option to purchase is exercised there shall be credited on the purchase price (1) all amounts then in the hands of the lessor as trustee not otherwise due for distribution under the terms of the trust agreement with the certificate holders, (2) any amounts in the hands of the lessor received as compensation for the appropriation to public use of any part of the premises, (3) the amount of cash in the depreciation fund, including the net proceeds of any securities other than land trust certificates, and the option price of any land trust certificates held in the depreciation fund, and (4) the net unappropriated proceeds of any insurance; that the lessee shall pay all taxes and other charges on the depreciation fund; that in case the lessee fails to exercise the option to purchase or the lease is terminated on account of

default of the lessee, the depreciation fund shall become the property of the lessor as liquidated damages on account of depreciation in value of the premises; that in case of condemnation of a substantial portion of the premises the lessee shall exercise the option given it to purchase; that there shall be no diminution of rent in case of condemnation or loss by fire of any portion of the premises; and that the lessee shall pay all taxes and insurance on the property and keep it in good condition, order, and repair. (R. 27–28.)

The land trust certificates were sold to the public at $1,010 to yield a return of 4.95 per centum. The certificates recite, among other things not important here, that the holder is the owner of a portion, stated in 3,500ths, "of the equitable and beneficial interest" in the real property under lease to the taxpayer; that the trustee will account to the registered owner of the certificate quarterly for the owner's proportionate share of the trust estate or the net proceeds thereof; and that the certificate is subject to all of the terms of the declaration of trust under which it was issued. (R. 28.)

The declaration of trust executed by the trustee, in addition to the terms of the certificates as set forth in the preceding paragraph, recites the terms of the option to purchase given the taxpayer under the lease; that the certificates are subject to call at prices ranging from $1,010 to $1,030, depending upon the period during which the right is exer-

cised, plus an adjustment for accrued rentals; that in the event the property is sold distribution of the net proceeds shall be made among the holders of the certificates; that the duties of the trustee shall be restricted to the collection of rent from the trust estate and the distribution of the net proceeds thereof to the certificate holders; and that the holders of the certificates shall have no right to call for a partition of the trust estate. (R. 28.)

In its return for the taxable years here involved, taxpayer claimed depreciation on the three buildings based upon a useful life of 40 years. The Commissioner disallowed the claimed deductions on the ground that the right to take depreciation on the property follows the legal title thereto. The Board of Tax Appeals, however, held that the deed given was in reality a mortgage and that the transaction was not one in which the taxpayer lost its right to deductions for exhaustion of the property conveyed (R. 29–30). The Circuit Court of Appeals affirmed (R. 173).

## SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred in holding:

1. That, under the facts herein, the taxpayer in 1928 in reality accomplished a mortgage of its real property to secure a loan and not a sale thereof.

2. That the taxpayer did not effect a sale of its property in the year 1928, and that no absolute conveyance to the trustee was intended.

3. That the transaction in 1928 was not one in which the taxpayer lost its right to deductions for exhaustion of the property conveyed.

4. That the taxpayer-corporation was entitled to deductions for depreciation in each of the taxable fiscal years ending January 31, 1930 and 1931 on its property to which it had previously had title but which it occupied during the taxable years in question as lessee under the 99-year leases.

5. That the decision of the Board of Tax Appeals should be affirmed, and in failing to order that judgment be entered for the Commissioner of Internal Revenue.

## REASONS FOR GRANTING THE WRIT

The decision below, allowing the taxpayer to deduct for depreciation upon the building which it holds under the 99-year lease, is squarely in conflict with the decision of the Court of Appeals for the District of Columbia in *City National Bank Bldg. Co.* v. *Helvering*, 98 F. (2d) 216.

In the latter case the taxpayer, like the taxpayer here, had once owned a building and the land upon which it was situated, for which it had paid $1,525,000. In 1925 the taxpayer conveyed the property in fee to an Ohio bank, receiving in exchange $930,000 in cash and a valuable lease on the property for 99 years, renewable forever, with an exclusive option to repurchase. The Ohio bank contemporaneously declared a trust of the property,

as the Huntington National Bank did here, for the holders of 1,000 shares of the equitable ownership in fee. These so-called "land trust certificates" were sold to the public. The rental under the lease was precisely the amount necessary to pay the interest on these certificates. The court held that the taxpayer's claimed deduction for depreciation was correctly disallowed.

That decision, as the court below recognizes (R. 176), is squarely in conflict with the decision below. Indeed, the *City National Bank* case was in itself in conflict with a prior decision of the court below in *Commissioner* v. *H. F. Neighbors Realty Co.*, 81 F. (2d) 173, which was followed in the instant case.

The court in the *City National Bank* case stated that it was unable to follow the decision in the *Neighbors* case largely because it arrived at a different conclusion as to the effect to be attributed to the decision of this Court in *Senior* v. *Braden*, 295 U. S. 422. In that case the question involved was whether Ohio "land trust certificates", such as those involved in these cases, represented equitable interests in land, or were choses in action, for purposes of taxation by Ohio of intangible property. The Court held that the certificates represented interests in land and were consequently not taxable. The Court of Appeals for the District of Columbia pointed out that since that decision had established that the certificates represented an interest in land,

the conveyance to the trustee was a sale, and not a mortgage. As an additional reason for disallowing the claimed deduction, which is equally applicable in the present case, the court pointed out that the taxpayer had no capital investment in the property, since it had received back its whole original investment.

The court below, notwithstanding these lines of reasoning, adhered to its former decision in the *Neighbors* case. There is thus presented a clear-cut conflict both as to the effect to be attributed to the decision in *Senior* v. *Braden, supra,* and ultimately, as to the propriety of deductions for depreciation by the lessee in transactions of this character. That conflict should be resolved by this Court.

## CONCLUSION

Wherefore it is respectfully submitted that this petition for a writ of certiorari should be granted.

ROBERT H. JACKSON,
*Solicitor General.*

MAY 1939.

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